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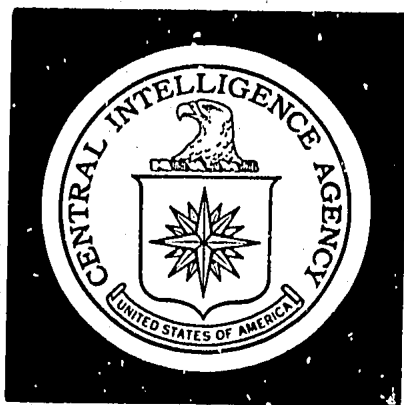
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**DIRECTORATE OF
INTELLIGENCE**

Intelligence Memorandum

*Papua-New Guinea: Economic Prospects
In A Troubled Political Setting*

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August 1971

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
August 1971

INTELLIGENCE MEMORANDUM

PAPUA-NEW GUINEA:
ECONOMIC PROSPECTS IN A TROUBLED POLITICAL SETTING

Introduction

1. Australia's Territory of Papua-New Guinea is among the world's few remaining overseas dependencies and contains one of the two United Nations Trust Territories still existing. Soon to become an important new world copper supplier and to achieve self-government, the territory is wracked with numerous tribal and regional differences threatening its political stability. This memorandum examines the territory's major political-economic problems and evaluates its recent economic trends and prospects.

Discussion

Setting

2. Australia's Territory of Papua-New Guinea includes about half the large island of New Guinea and several smaller island groups, including New Britain, New Ireland, and Bougainville. ^{1/} New Guinea accounts for about 90% of the territory's total land area of 183,000 square miles, somewhat

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

1. *The Territory of Papua-New Guinea consists of two parts: the Trust Territory of New Guinea and the Territory of Papua. The Trust Territory includes the northeastern section of the main island of New Guinea plus the islands of the Bismarck Archipelago (the Admiralty Islands, New Britain, New Ireland, and Hanover) and the two northernmost islands of the Solomon group (Bougainville and Buka). The Territory of Papua includes the southeastern section of the main island and several smaller island groups in Milne Bay. The Western half of the main island, West Irian, is part of Indonesia.*

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larger than California, and a like percentage of the region's 2.4 million inhabitants (see the map, Figure 1). Despite their small size and population, the three smaller islands support much of the territory's modern economic activity. The largest plantations are located on New Britain and New Ireland, which account for almost half of total export earnings, while Bougainville is the site of large copper deposits now being developed.

3. The territory came into Australian hands in the early part of this century. During the latter part of the nineteenth century, control of the region was divided between Germany and Britain. Germany held what is now the Trust Territory of New Guinea while the Territory of Papua was under British control. Soon after Australia became independent in the early 1900s, Britain turned Papua over to Canberra. Germany, meanwhile, retained control over its area until the end of World War I, when Australia took control under an agreement with League of Nations and later with the United Nations. Since 1949 the two territories have been administered by Canberra as a single unit.

4. Although no definite timetable has been set, Canberra plans to grant self-government in the next few years and independence probably sometime after the mid-1970s. However, the territory's numerous regional and tribal groupings – there are perhaps a thousand tribes speaking about 700 dialects – generally distrust one another, and these differences have mounted at the prospect of self-government. On the main island of New Guinea, for example, conservative highland natives oppose early self-government, fearing control by the more educated coastal people who strongly favor independence.

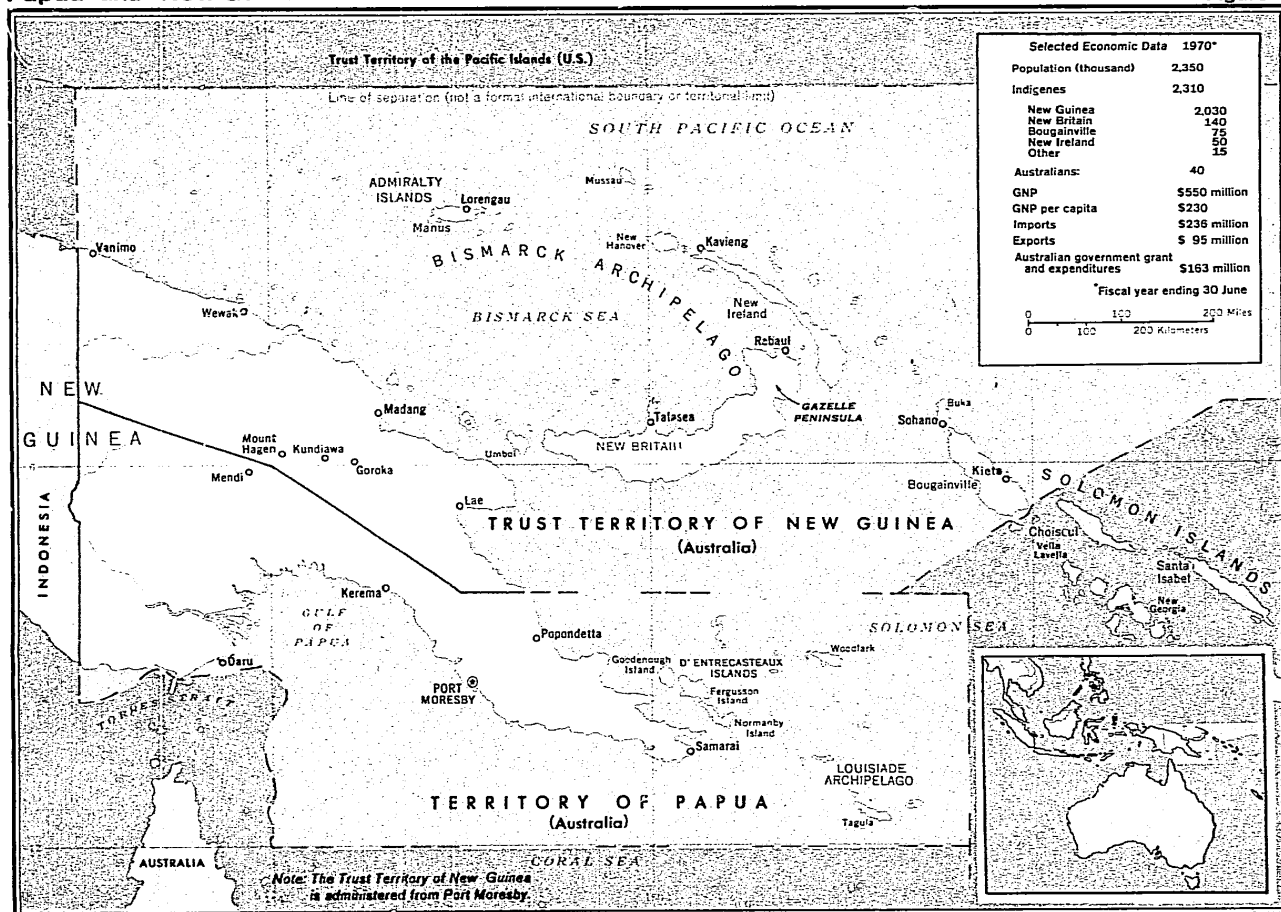
5. Tribal differences also threaten an eventual split between New Guinea and the smaller island groups. New Britain, New Ireland, and Bougainville have no cultural or ethnic ties with New Guinea, and, because of their small population, they fear political domination by the main island. Many also resent New Guinea's favored position in the territory's economy. The bulk of government spending, for example, is apparently concentrated on the main island. The separatist movement is especially strong on Bougainville, partly because of the large copper deposits being developed there. Island leaders feel the financial benefits from copper should accrue to Bougainville and have made clear their desire to break with the main island after independence is achieved.

6. Racial antagonism between the indigenous population and the roughly 40,000 Australians living in the territory is also on the rise. Resentment against Australians is especially strong on New Britain where sporadic racial violence, led by the large Tolai tribe, has erupted in the past year or so. Although accounting for about half the island's population, the Tolai own less than 2% of the land area – most of the better land

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Papua and New Guinea

Figure 1



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is held by Australians. Many Tolai are demanding return of alienated land and want to dislodge Australians from their leading position in the local economy. Racial problems are less dramatic on the other islands but have been growing as the expatriate community increases. Over the past decade the number of Australians in the Territory about doubled.

Economic Structure and Trends

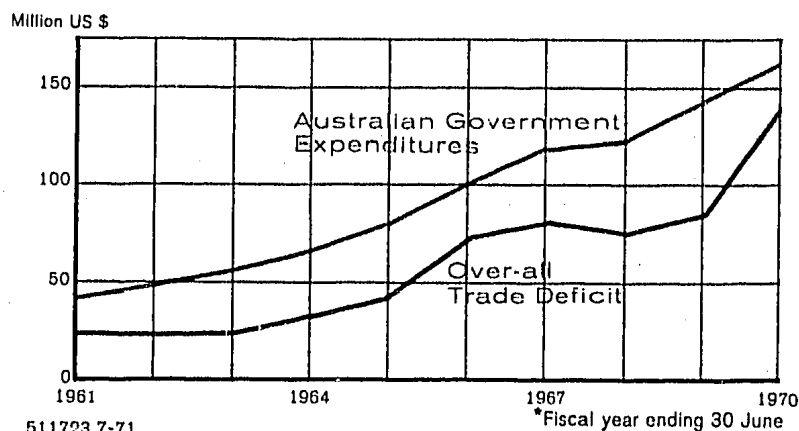
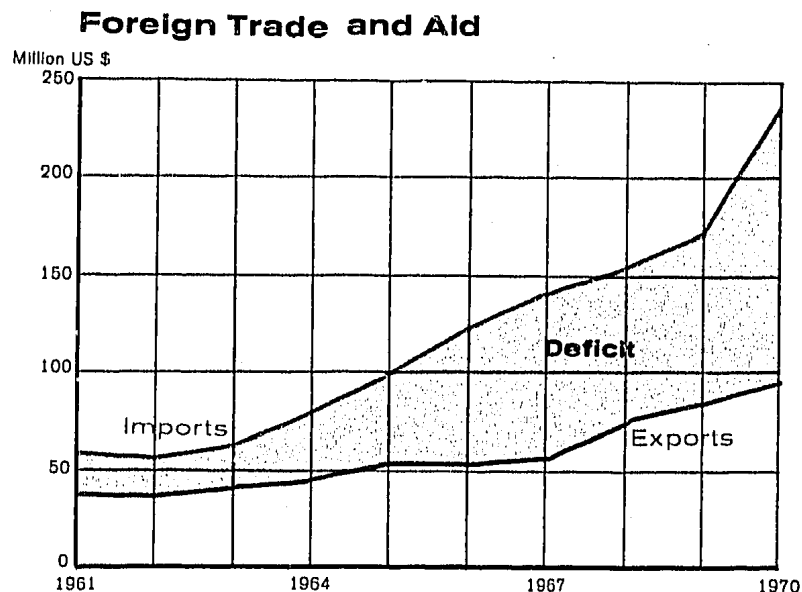
7. So far, political and social problems have not adversely affected the economy. Canberra has effectively contained the discord, and the region's small modern economy is in reality an appendage of the Australian economy. More than two-thirds of export production comes from Australian-owned operations, and about half of total foreign trade is with Australia. All commercial banks are branches of Australian banks, and Australian currency is used in the territory. Underlying these close ties is Canberra's large spending program in the territory. In 1970 2/, total Australian government expenditure there amounted to about \$160 million - equal to an extraordinary 30% of gross national product (GNP). In addition to financing a large portion of local government spending, these outlays have enabled the territory to run very large trade deficits - \$140 million last year (see Figure 2).

8. Native involvement in the modern economy is increasing, but the great bulk of the indigenous population still live a traditional way of life, concerned almost exclusively with producing enough food for their immediate needs. Some earn cash income as occasional workers on Australian plantations or by growing small amounts of cash crops. Although wage employment in government and industry has increased considerably in recent years, the number of persons involved remains well below 100,000 and the economy in general still rests essentially on agriculture. It accounts for perhaps one-half of GNP and about 75% of total exports. This will change dramatically, however, when production from Bougainville's copper project begins in mid-1972.

9. Because of the growing Australian presence, the tempo of economic activity in the region increased sharply during the 1960s. Real GNP grew by about 7% annually while per capita incomes nearly doubled and now amount to about \$230 - a relatively high level in comparison with those in most less developed countries. Much of the growth occurred on New Guinea where heavy local government spending was a major stimulus to economic expansion. Total territorial government outlays rose about fourfold between 1960 and 1970 to some \$230 million as shown in the table, and most of the increase was on New Guinea. The main island has

2. All annual data in this memorandum refer to fiscal years ending 30 June of the stated year.

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CONFIDENTIAL**Figure 2**

attracted practically all of the region's new Australian residents over the past decade, many of whom came as a result of new business opportunities opened up by the government's spending program. Meanwhile, higher income and other tax receipts from the growing Australian community financed a large part of the government's expanded operations.

10. Much of the increased activity on New Guinea has been concentrated around main cities such as Port Moresby and Lae where construction and service industries expanded sharply. Some light manufacturing industries have also been established to help satisfy the demand for consumer goods. Outside the major urban centers the all

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Government Receipts and Expenditures a/

	Million US \$						
	<u>1960</u>	<u>1963</u>	<u>1965</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>1970</u> <u>b/</u>
Expenditures	43.3	67.1	100.9	134.5	149.6	167.4	226.0
Revenues	14.8	20.2	31.3	49.5	53.5	61.7	83.9
Other receipts <u>c/</u>	--	2.0	7.1	6.9	9.4	12.9	28.0
Australian grant aid <u>d/</u>	28.7	44.8	62.7	78.2	86.9	97.7	107.5

a. Fiscal years ending 30 June.

b. Estimated.

c. Mainly domestic loans

d. Excluding Australian government spending outside the territorial budget, which in FY 1970 amounted to about \$55 million.

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important agricultural sector grew fairly rapidly. Coffee production, the only export crop grown primarily by native farmers, jumped sharply while rubber output from Australian-owned plantations increased gradually despite stagnating world demand (see Figure 3). Both commodities benefit from special treatment in the Australian market.

11. New Britain and New Ireland also did well during the 1960s. Their modern economies are almost completely dependent on plantation agriculture, and except for timber and a few processing plants, there is little other industry on the islands. They provide most of copra and cocoa production, the region's major exports, and output from plantations rose substantially over the past decade. Dramatic gains were made in increasing cocoa output as new areas were brought under cultivation while copra production grew more gradually. Largely because of the gains, plus increased coffee output on New Guinea, the region's overall export earnings grew at an average annual rate of 11% between 1961 and 1970. Bougainville contributed somewhat to this good performance, but until recently was of little significance to the region's economy.

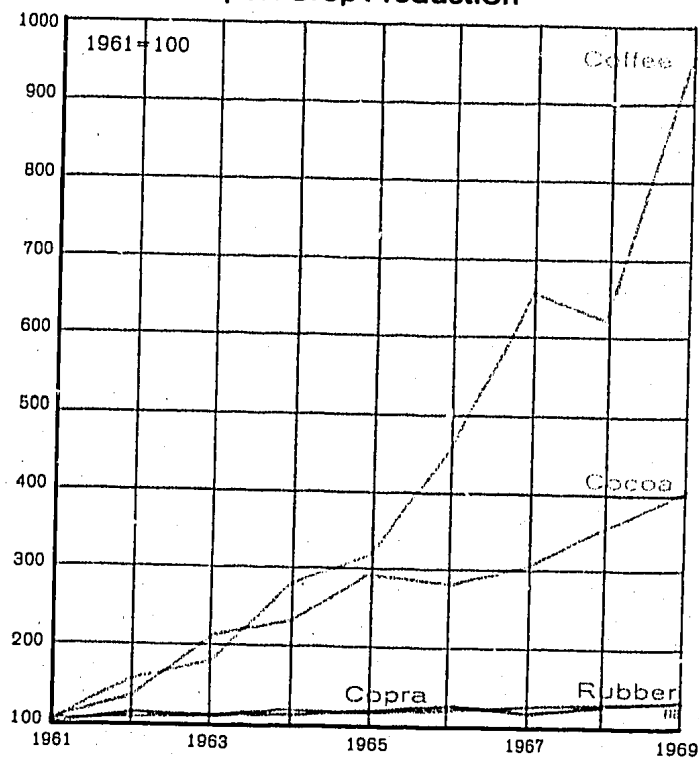
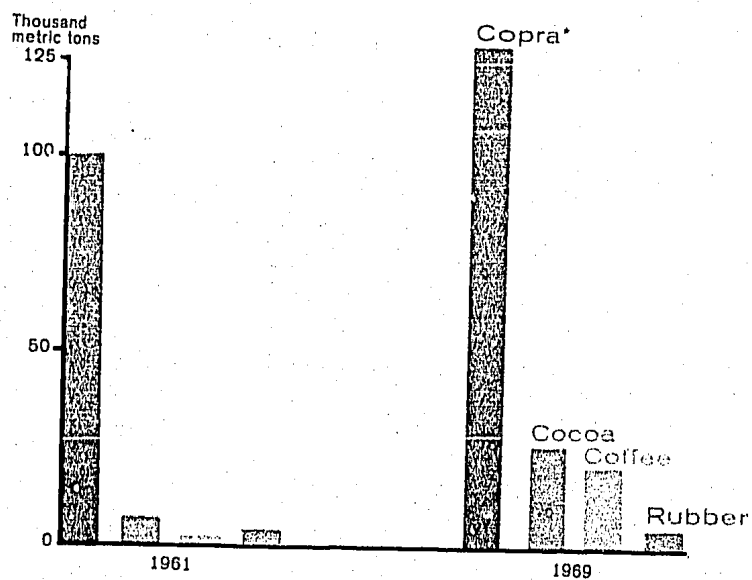
12. Development of large copper deposits on Bougainville is now leading the territory's growth, which jumped to around 15% annually in the past year or so. Since mid-1969, investment outlays on the project have exceeded \$300 million, and the 3,800 square mile island has a boom-town atmosphere. The heightened pace of activity is reflected in the ninefold increase in goods coming into Bougainville's main port at Kieta - from about \$5 million in 1969 to nearly \$50 million in 1970. In addition to construction at the mine itself, the project has required construction of roads, a new deep-water port at Anewa Bay, a powerplant, and a townsite at Arawa. The town will eventually house some 8,500 persons, or more than 10% of the island's present population.

13. The other islands have indirectly benefited from the Bougainville project. International attention has been attracted to the territory's potential mineral resources, and by late 1970 more than 220 firms held prospecting rights covering roughly 85,000 square miles. In 1968, less than 20 firms held prospecting rights and in 1966 there were only six. Most of the increased activity is concentrated around New Guinea, where several mining and oil firms have been operating. During 1970, some \$15 million was spent on exploration in the territory, excluding work associated with the Bougainville project.

Bougainville Copper

14. Bougainville will become an important new source of Free World copper within the next few years. By 1973, when full production begins, the island will export 200,000 tons of copper - equal to about 8% of

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CONFIDENTIAL**Figure 3****Production of Export Crops****Index of Export Crop Production****Production**

*Data are for 1968.

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total Free World exports in 1969. In addition to copper, output from the Bougainville operation will include 500,000 ounces of gold and 1 million ounces of silver annually. The deposit is being developed by Bougainville Copper Pty. Ltd. (BCP) which is controlled by the British-owned Rio Tinto-Zinc Corporation through its Australian subsidiary Conzinc Riotinto. The territorial government holds a 20% equity share in BCP. Much of the financing will come from US sources, including a \$28 million loan from the Export-Import Bank. A consortium headed by Bank of America will provide a Eurodollar loan of over \$100 million.

15. Record high prices in the latter 1960s helped spur development of Bougainville's low-grade copper resources, but the average price received between 1968 and mid-1970 has fallen from about 65¢ per pound 3/ to around 45¢. Nonetheless, the Bougainville project will probably be an extremely profitable undertaking. At the 45¢ price, net operating profits would average an extraordinary 50% of gross sales through the mid-1970s. Operating costs are expected to be among the lowest in the world, and BCP's tax burden will be extremely light because of a tax holiday lasting until 1976. Even after this ends, tax payments would amount to only about 13% of total sales revenue. In recent years the comparable figure for mining operations in Zambia and Chile was more than double that rate. Moreover, BCP will have no trouble selling its output of copper concentrates. Agreements have already been reached to sell at least half of BCP's production to Japanese smelters, and most of the remainder will go to smelters in West Germany and Spain. Contracts call for a minimum purchase price of 30¢ a pound, a price at which BCP feels it can still earn a profit.

16. Because of the exceptionally light tax burden on the copper industry, government earnings from copper will be relatively small for at least several years. During the first years of operation the chief source of income will be the government's 20% equity share in BCP. Although industry profits will be high, most of this will go to repay loans, and actual income to the government from its share of ownership will probably run about \$10 million annually through 1975 if present prices are maintained. Until then the only other government receipts from copper will be a small royalty payment amounting to about \$3 million a year. Additional revenues from import duties and income taxes on workers and supporting firms should provide considerable additional sums to territorial coffers. Government revenues by 1973 should jump at least 25% above the 1970 level of \$84 million. After the tax holiday on profits ends in 1976, direct tax payments will be some \$15-\$20 million higher annually.

17. For most Bougainville natives the copper industry will have little impact on their way of life. Because the industry is highly mechanized,

3. London Metal Exchange price for wire bars.

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the entire operation will directly employ only about 2,300 persons, of whom about 1,000 will be expatriates. This compares to a workforce of about 50,000 persons in Zambia where copper output is three to four times what Bougainville's will be. Few transport workers will be required, for example, because concentrates will be shipped by pipeline rather than truck or rail from the mine area to the port. Numerous service industries are expected to sprout up on the island to support BCP operations, however, and the territorial government is spending considerable sums to improve educational facilities and services such as water supplies.

Prospects and Conclusions

18. Led by Bougainville's emerging copper industry, economic prospects for Papua-New Guinea over the next half decade are very bright. Once full production begins in 1973, copper sales will more than match the region's total export earnings in 1970 and the industry will become an important source of government revenues, especially after the industry's tax holiday ends in 1976. Bougainville's small modern economy, meanwhile, will increase many-fold, and development of the copper deposits should generate some new industries on the island. Economic growth on New Britain and New Ireland will be nowhere near as spectacular, but these islands will probably benefit from such developments as increasing timber exploitation and development of new export crops such as palm oil.

19. The main island of New Guinea should also do well in the coming years. As long as Australia maintains its aid program at about present levels, the pace of economic activity on the island will remain high. Although Canberra is planning no major increases in aid, the island will benefit from more intensive minerals and petroleum exploration. Total exploration expenditures in the area, mainly on New Guinea, will increase to nearly \$30 million this year, and industry experts are especially optimistic about finding crude petroleum deposits around the Papuan Gulf. Copper has also been located in large quantities near the West Irian border. Meanwhile, the island's vast timber resources are attracting increasing foreign interest especially among Japanese investors. Like the Bougainville project, however, these are essentially enclave-type activities, and the impact on the native population will be limited.

20. Despite the region's favorable economic outlook, political and social problems will remain and likely grow. Occasional inter-tribal differences are almost certain to occur as is racial violence against the Australians as their presence grows. But as long as Canberra maintains control over the territory, the problems are not likely to get out of hand.

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The present Australian government still considers independence some years away. The timing of independence, however, could change dramatically, especially if a labor government comes to power in Canberra. Australia's Labor Party has stated its intention of granting independence if it gains power, and in that event separatist movements on the smaller islands would be a major threat to the area's stability.

21. Even if the smaller islands seceded, the economic impact would not be especially great. New Guinea would probably be hardest hit since the smaller islands account for an important share of territorial exports and government revenues, and the loss would have to be made up by increased Australian aid. Even this may be unnecessary if substantial mineral or oil exploitation gets under way. The other islands would not be seriously harmed by secession, although Canberra has threatened to cut off aid to any breakaway group. Bougainville has the copper industry, and there is ample room to increase taxes on the industry and still maintain its profitability. New Britain and New Ireland would suffer more from loss of Australian aid, but their small economies could probably get by as long as Australian planters continued to operate. Moreover, there is a good chance that New Britain and New Ireland would unite with Bougainville in any secessionist move.

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